STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Interstate Power Company and South Beloit Water, Gas and Electric Company	:	
Joint Petition for Approval of Residential Delivery Services Implementation Plan submitted pursuant to Section 16-105 of the Illinois Public Utilities Act.	:	**01-0528**
Interstate Power Company	:	
Petition for Approval of Delivery Services Tariffs submitted pursuant to Section 16-108 of the Illinois Public Utilities Act	:	**01-0628**
South Beloit Water, Gas & Electric Company	:	
Petition for Approval of Delivery Services Tariffs submitted pursuant to Section 16-108 of the Illinois Public Utilities Act.	:	**01-0629 (Consolidated)**

<u>ADMINISTRATIVE LAW JUDGES' PROPOSED ORDER</u>

February 4, 2002

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Interstate Power Company and South Beloit Water, Gas and Electric Company	:	
Joint Petition for Approval of Residential Delivery Services Implementation Plan submitted pursuant to Section 16-105 of the Illinois Public Utilities Act.	:	**01-0528**
Interstate Power Company	:	
Petition for Approval of Delivery Services Tariffs submitted pursuant to Section 16-108 of the Illinois Public Utilities Act	:	**01-0628**
South Beloit Water, Gas & Electric Company	:	
Petition for Approval of Delivery Services Tariffs submitted pursuant to Section 16-108 of the Illinois Public Utilities Act.	:	**01-0629 (Consolidated)**

ADMINISTRATIVE LAW JUDGES' PROPOSED ORDER

By the Commission:

I. Procedural History

On September 28, 2001, Interstate Power Company ("IPC") and South Beloit Water, Gas and Electric Company ("SBWGE"), or collectively ("Companies"), filed verified Petitions with the Illinois Commerce Commission ("Commission"), pursuant to Sections 16-104 and 16-108 of the Public Utilities Act ("Act"), seeking Commission approval of their Delivery Services Tariffs for Residential Customers ("DSTs" or "Tariffs"). Attached to the Petitions and in support thereof, were the proposed Tariffs and also the prepared testimony of Martin Seitz, Brian Penington and Enrique Bacalao. IPC's Petition was docketed as Docket 01-0628 and SBWGE's Petition was docketed as Docket 01-0629.

IPC is a Delaware Corporation. On January 1, 2002, IPC merged into its affiliate, IES Utilities Inc., an Iowa corporation. That merger was approved by the Commission on May 23, 2001, in Docket 00-0261. On January 1, 2002, IES Utilities Inc. changed its name to Interstate Power and Light Company ("IPL"). SBWGE is an Illinois Corporation. IPC and SBWGE own and operate electric distribution systems in Illinois.

Pursuant to notice given in accordance with the law and the rules and regulations of the Commission, a prehearing conference was held in this matter before duly authorized Administrative Law Judges ("ALJs") of the Commission at its offices in Chicago, Illinois, on October 16, 2001. Thereafter, an evidentiary hearing was held at the Commission's offices in Chicago, Illinois, on January 3, 2002. Appearances were entered at the prehearing conference or at one or more of the hearings by counsel on behalf of the Companies and the Staff of the Commission ("Staff"). At the conclusion of the January 3, 2002 hearing, the record was marked "Heard and Taken."

At the hearing, the Companies presented the following witnesses' testimony: Mr. Martin Seitz, Manager of Financial Planning and Analysis at Alliant Energy Corporate Services, Inc.; Mr. Brian Penington, Regulatory Pricing Analyst at Alliant Energy Services Company, Inc.; and Mr. Enrique Bacalao, Assistant Treasurer and Director of Finance at Alliant Energy Corporation and Assistant Treasurer of Wisconsin Power and Light Company and Interstate Power Company. Staff presented the testimony of the following witnesses: Ms. Dianna Hathhorn, of the Commission's Accounting Department of the Financial Analysis Division; Ms. Sheena Kight, Financial Analyst in the Finance Department of the Financial Analysis Division; Ms. Cheri L. Harden, Rate Analyst in the Rates Department of the Financial Analysis Division; Dr. Eric P. Schlaf, Economist in the Energy Division; and Mr. Thomas Q. Smith, Accountant in the Accounting Department of the Commission's Financial Analysis Division.

The Companies and Staff filed Initial Briefs on January 16, 2002, and Reply Briefs on January 25, 2002.

II. Statutory Authority, Background and Overview

The offering of delivery services pursuant to the Illinois Customer Choice Law is addressed in a number of sections in Article XVI of the Act. The definition of "delivery services" and the timeline for offering such services are set out, in part, in Sections 16-102 and 16-104 of the Act, respectively. Section 16-102 defines "delivery services" as "those services provided by the electric utility that are necessary in order for the transmission and distribution systems to function so that retail customers located in the . . . utility's service area can receive electric power and energy from suppliers other than the . . . utility, and shall include, without limitation, standard metering and billing services."

The dates by which delivery services are to be offered to non-residential customers are identified in subsections (1), (2), (2.5) and (3) of Section 16-104(a). For residential customers, Section 16-104(a)(4) provides that delivery services shall be offered to all residential retail customers on or before May 1, 2002.

Section 16-108(a) provides in part that an electric utility "shall provide the components of delivery services that are subject to the jurisdiction of the Federal Energy Regulatory Commission at the same prices, terms and conditions set forth in its applicable tariff as approved or allowed to go into effect by that [agency]." The Illinois Commerce Commission "shall otherwise have the authority, pursuant to Article IX, to review, approve and modify the prices, terms and conditions of those components of delivery services not subject to the jurisdiction of the Federal Energy Regulatory Commission, including the authority to determine the extent to which such delivery services should be offered on an unbundled basis."

Section 16-108(b) provides that the Commission shall enter an order approving, or approving as modified, the delivery services tariff no later than 30 days prior to the date on which the utility must commence providing such services.

III. Test Year and Proposed Revenue Increase

For the test year in this proceeding, the Companies selected a historic test year consisting of the 2000 calendar year. No party objected to the use of a 2000 test year for this proceeding. The Commission, therefore, finds the Companies' proposed test year to be reasonable for purposes of establishing delivery services rates.

With respect to revenue requirements associated with providing delivery services, IPC initially proposed a delivery services revenue requirement of $5,409,000 and SBWGE proposed a delivery services revenue requirement of $3,262,000. At the conclusion of the hearing, IPC proposed a delivery services revenue requirement of $5,348,000 and SBWGE proposed a delivery service revenue requirement of $2,889,000. These recommendations include all of the Staff adjustments except for the recommended return on common equity rates that remain at issue in this proceeding.

Staff's proposed delivery services revenue requirement for IPC was $5,058,000 a difference of $351,000, or 6.49% less than that proposed by IPC. Staff's proposed delivery services revenue requirement for SBWGE was $2,725,000 (total revenue requirement of $2,772,000) a difference of $436,000 for delivery services revenues (a total revenue requirement difference of $389,000), or 13.79% less than the delivery services revenue requirement (12.31% less on total revenue requirement) proposed by SBWGE.

The Companies and Staff agreed on the distribution rate base and distribution revenue and expenses for the Companies. Accordingly, the agreed issues are outlined below. The cost of equity for IPC and SBWGE, the only issue in dispute, is discussed in greater detail. The Companies and Staff are also in agreement on all rate design and electronic signature issues.

IV. Rate Base

Both IPC and SBWGE filed proposed rate bases, which included amounts applicable to Illinois delivery services, which were based upon a mixture of direct assignment and allocation. (IPC Ex. 1.0, p. 5; SBWGE Ex. 1.0, p. 6).

Staff proposed that IPC's initial distribution rate base be decreased by $33,000 for materials and supplies. IPC agreed to the proposed adjustment. Staff and IPC agree that IPC's delivery services rate base for the 2000 test year is $13,982,000, as shown on Schedule 3 of Appendix A to this Order. The Commission concludes that this rate base is reasonable and should be approved.

Staff also proposed that SBWGE's distribution rate base be reduced by $1,260,000 for miscellaneous deferred debits. SBWGE agreed to the proposed adjustment. Staff and SBWGE agree that SBWGE's delivery services rate base for the 2000 test year is $7,603,000, as shown on Schedule 3 of Appendix B to this Order. The Commission concludes that this rate base is reasonable and should be approved.

V. Operating Revenues and Expenses

Staff recommended the following adjustments to IPC's distribution revenues and expenses: 1) a decrease of $73,000 for uncollectible expenses; and 2) a decrease of $4,000 for sales expense. IPC agreed to the adjustments. Giving effect to these agreed adjustments and the overall rate of return of 9.52% hereafter allowed for IPC in this Order, the Commission concludes that IPC's delivery services operating income statement for the test year, for purposes of this proceeding, is as shown on Schedule 1 of Appendix A attached hereto. The delivery services revenue requirement approved herein for IPC is $5,058,000.

Staff recommended the following adjustments to SBWGE's distribution revenues and expenses: 1) an increase of $47,000 in other revenue; 3) a decrease of $22,000 for uncollectible expenses; and 3) a decrease of $3,000 for advertising expense. SBWGE agreed to the adjustments. Giving effect to these agreed adjustments and the overall rate of return of 9.26% hereafter allowed for SBWGE in this Order, the Commission concludes that SBWGE's delivery services operating income statement for the test year, for purposes of this proceeding, is as shown on Schedule 1 of Appendix B attached hereto. The delivery services revenue requirement approved herein for SBWGE is $2,725,000.

VI. Capital Structure and Rate of Return

A. Capital Structure and Cost of Non-Equity Capital

Staff and the Companies agreed on the appropriate capital structures, for each Company, as of December 31, 2000, and the embedded costs of debt and preferred stock for both IPC and SBWGE. Their sole difference of opinion lies in assigning the proper costs of common equity within the agreed capital structures.

B. Cost of Common Equity

1. The Companies' Position

To estimate the cost of common equity for both IPC and SBWGE, Mr. Bacalao employed various methodologies, including Comparable Earnings Method, Capital Asset Pricing Model ("CAPM"), Discounted Cash Flow ("DCF"), and risk premium analyses. (IPC Ex. 3.0, p. 13 and SBWGE Ex. 3.0, p. 14).

Choice of Sample

Mr. Bacalao employed a sample consisting of all Value Line companies with a safety rank of 2 where the relevant data needed for the particular model was available. (IPC Ex. 3.0, pp. 14-15 and SBWGE Ex. 3.0, p. 15). Mr. Bacalao used the safety rating of the Companies' parent, Alliant Energy Corporation ("Alliant"), in the calculation because Value Line does not rate IPC and SBWGE.

Staff contends that Mr. Bacalao's Value Line analysis is flawed because Alliant has non-utility risk and because the resulting sample contains non-utility companies whose finances are not analagous to the Companies'. Staff argues that the inclusion of these companies in his sample produces an upward bias in calculating the cost of common equity.

Comparable Earnings Method

Mr. Bacalao developed two estimates of the cost of common equity for the Companies based on the Comparable Earnings method, one based on historical return on equity ("ROE") and one based on forecasted ROE. The first estimate was calculated from the Value Line published returns on book equity from 1991 to 2000 for the companies in his sample. The historical Value Line return on equity ranged from 14.4% to 18.6% with an average of 16.1%. The second estimate was calculated from Value Line estimates of return on equity for the years 2001 to 2006 for the companies in his samples. The forecasted return on equity ranged from 16.8% in 2001 to 17.2% in 2004-2006. The average forecasted return on equity is 17.0%. (IPC Ex. 3.0, pp. 15-16 and SBWGE Ex. 3.0, pp. 15-16).

Staff, in its briefs, points out that the Commission has rejected this methodology in several previous cases.

CAPM Analysis

Mr. Bacalao developed four estimates based on the CAPM theory. (IPC Ex. 3.0, p. 17 and SBWGE Ex. 3.0, pp. 17). The CAPM is defined as follows:

$$R_e = R_f + \beta \times (R_m - R_f)$$

Where	R_e	=	the required rate of return
	R_f	=	the risk-free rate
	β	=	beta
	R_m	=	the expected return on the market

To estimate the risk-free rate, Mr. Bacalao used the 3.25% 3-month Treasury bill rate and the 5.37% 30-year Treasury bond yield on September 7, 2001. (IPC Ex. 3.0, pp. 17-18 and SBWGE Ex. 3.0, pp. 18-19)

To calculate his sample betas, Mr. Bacalao modified the beta component of the CAPM to account for the effect of a company's financial leverage on its risk. Mr. Bacalao removed the effect of financial leverage from his sample companies' betas using market-value capital structures to obtain an unlevered beta and then re-levered it using the proposed book-value capital structure of IPC and SBWGE. This produced sample betas of 1.03 for IPC and 1.0 for SBWGE. Mr. Bacalao then used the re-levered betas for his sample companies to estimate the cost of equity with the CAPM methodology. (IPC Ex. 3.0, pp. 16-17 and SBWGE Ex. 3.0, p. 17).

Mr. Bacalao used two estimates of the market return parameter. The first was a 15.45% market return that represented the average of Annual Total Returns of Large Company Stocks of 13.3% and Small Company Stocks of 17.6%. The second was an 8.1% market risk premium for large company stocks from Ibbotson Associates. (IPC Ex. 3.0, p. 18 and SBWGE Ex. 3.0, pp. 18-19).

Mr. Bacalao inserted the current 3-month U.S. Treasury bill yield of 3.25%, the 30-year long-term U.S. Treasury bond yield of 5.37%, an expected market risk return estimate of 15.45%, and a beta estimate of 1.03 for IPC and 1.00 for SBWGE into the CAPM formula. This produced cost of common equity estimates of 15.79% and 15.73% for IPC and 15.48% for SBWGE.

He then inserted the current 3-month U.S. Treasury bill yield of 3.25%, the 30-year long-term U.S. Treasury bond yield of 5.37%, a market risk premium estimate of 8.1%, and a beta estimate of 1.03 for IPC and 1.00 for SBWGE into the CAPM formula. This produced cost of common equity estimates of 11.57% and 13.69% for IPC and 11.37% and 13.49% for SBWGE. The average cost of equity for the CAPM equations is 14.19% for IPC and 13.96% for SBWGE. (IPC Ex. 3.0, pp. 17-18 and SBWGE Ex. 3.0, pp. 18-19).

In response, Staff argued that Mr. Bacalao's CAPM formulation was flawed. Staff contended that his use of high beta estimates resulted in a higher total risk than is appropriate for utility companies. Staff also noted that the Commission has previously rejected the use of leverage adjustments to beta in similar cases.

DCF Analysis

Mr. Bacalao performed a two-stage DCF analysis. (IPC Ex. 3.0, pp. 19-20 and SBWGE Ex. 3.0, pp. 19-20). He used five-year forecasted growth rate estimates from Zacks Investment Research ("Zacks") for the first stage and the long-run rate of inflation from Ibbotson Associates for the terminal growth rate. (IPC Ex. 3.0, pp. 19-20 and SBWGE Ex. 3.0, p. 20). The average cost of equity derived from Mr. Bacalao's DCF model is 7.519% for both IPC and SBWGE. (IPC Ex. 3.0, p. 20 and SBWGE Ex. 3.0, p. 20).

Risk Premium Analysis

Mr. Bacalao developed three risk premium estimates using long, intermediate and short term time horizons. The equity risk premiums were based on historical data and taken from Ibbotson Associates and matched the chosen time horizons. As approximations of the risk free rate, Mr. Bacalao used the 30-year treasury bond yield for the long-term horizon, the 10-year treasury bond yield for the intermediate-term horizon, and the 1-year treasury bill yield for the short-term horizon. The expected return on equity estimates derived from these time horizons range from 12.61% to 13.47%, with an average of 13.12% for both IPC and SBWGE. (IPC Ex. 3.0, p. 22 and SBWGE Ex. 3.0, pp. 22-23).

Staff notes that the Commission has previously rejected the use of historical risk data in determining the forward looking cost of equity because "it contains information that may no longer be relevant to investors." (Order, Docket 95-0076, p.70).

Recommendation

Mr. Bacalao's estimates of the cost of common equity using these different methodologies ranged from 7.519% to 17.0%, with intermediate values of 16.1%, 14.19% and 12.12%. Mr. Bacalao concluded that IPC's and SBWGE's respective costs of equity are 13.59% and 13.54%. Mr. Bacalao recommended a cost of equity for both Companies of 13.5%. (IPC Ex. 3.0, p. 23 and SBWGE Ex. 3.0, p. 23).

2. Staff's Position

Staff witness, Sheena Kight, estimated the cost of common equity for IPC and SBWGE with DCF and risk premium models. These models cannot be applied directly to IPC or SBWGE because the Companies' common stock is not market-traded. Therefore, Ms. Kight derived her estimates by applying these models to sample groups of utility companies. (Docket 01-0628 Staff Ex. 2.0CR, pp. 9-10 and Docket 01-0629 Staff Ex. 2.0C, p. 10).

Choice of Sample

The first sample Ms. Kight selected for the IPC analysis was comprised of nine cash-dividend paying, market-traded electric utilities within the *Standard & Poor's Utility Compustat* database that had Standard & Poor's ("S&P") credit ratings of A- to AA; that were not involved in any large, pending merger; and for which Value Line beta estimates and either Institutional Brokers Estimate System ("IBES") or Zacks growth forecasts were available ("Electric Sample"). The second sample consisted of eight cash-dividend paying, market-traded natural gas distribution utilities selected from the *Standard & Poor's Utility Compustat* database that had S&P credit ratings of A- to AA; that were not involved in any large, pending merger; and for which Value Line beta estimates and either IBES or Zacks growth forecasts were available ("Gas Sample"). (Docket 01-0628 Staff Ex. 2.0CR, pp. 10-11).

The first sample used by Ms. Kight for the SBWGE analysis was comprised of six cash-dividend paying, market-traded electric utilities within the *Standard & Poor's Utility Compustat* database that had S&P credit ratings of A to AA+; that were not involved in any large, pending merger; and for which Value Line beta estimates and either IBES or Zacks growth forecasts were available ("Electric Sample"). The second sample consisted of six cash-dividend paying, market-traded natural gas distribution utilities selected from the *Standard & Poor's Utility Compustat* database that had S&P credit ratings of A to AA+; that were not involved in any large, pending merger; and for which Value Line beta estimates and either IBES or Zacks growth forecasts were available ("Gas Sample"). (Docket 01-0629 Staff Ex. 2.0C, pp. 11-12).

In order to find comparable companies for her samples, Ms. Kight used IPC's and SBWGE's pre-October 15, 2001, S&P's credit ratings and business profiles. On that date, S&P downgraded the Companies' credit ratings because of their parent company's, Alliant's, "increased focus on expanding its higher-risk, non-regulated businesses."

The Companies argue that Ms. Kight's gas and electric samples, because they are comprised only of utility companies, are too narrowly drawn for an accurate computation of the cost of common equity. Morever, they contend the gas sample, upon which she bases her recommendation, has little relevance to the issues in these electric delivery service tariff cases.

DCF Analysis

DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments. Because a DCF model incorporates time-sensitive valuation factors, Ms. Kight contended that the DCF model must correctly reflect the timing of the dividend payments that stock prices embody. The companies in Ms. Kight's proxy samples pay dividends quarterly. Therefore, Ms. Kight applied a constant-growth quarterly DCF model. (Docket 01-0628 Staff Ex. 2.0CR, pp. 13-14 and Docket 01-0629 Staff Ex. 2.0C, pp. 13-15).

In Ms. Kight's view, the DCF methodology requires a growth rate that reflects the expectations of investors. Ms. Kight measured the market-consensus expected growth rates with projections published by IBES and Zacks. The growth rate estimates were combined with the closing stock prices and dividend data as of November 14, 2001. Based on this growth, stock price, and dividend data, Ms. Kight's DCF estimates of the cost of common equity were 11.32% for the IPC Gas Sample and 12.44% for the IPC Electric Sample. Similarly, she estimated 11.00% for the SBWGE Gas Sample and 12.25% for the SBWGE Electric Sample. (Docket 01-0628 Staff Ex. 2.0CR, p. 17 and Docket 01-0629 Staff Ex. 2.0C, p. 17).

The Companies note that Ms. Kight's ultimately rejected electric sample estimates are much closer to Mr. Bacalao's estimates than the estimates derived from the gas sample that she chose to rely upon.

Risk Premium Analysis

According to financial theory, the required rate of return for a given security equals the risk-free rate of return plus a risk premium associated with that security. The risk premium methodology is consistent with the theory that investors are risk-averse. That is, investors require higher returns to accept greater exposure to risk. In equilibrium, two securities with equal levels of risk should have equal rates of return. Ms. Kight used a one-factor risk premium model, the CAPM model, to estimate the cost of common equity. The risk factor, used in CAPM, is market risk. (Docket 01-0628 Staff Ex. 2.0CR, pp. 18-19 and Docket 01-0629 Staff Ex. 2.0C, pp. 18-19).

The CAPM model requires the estimation of three parameters. They are: the beta, the risk-free rate and the rate of return required by the market. Ms. Kight used Value Line's adjusted beta estimates for the companies in her samples. The average beta estimate for the IPC Electric Sample was 0.51, while the average beta estimate for the IPC Gas Sample was 0.58. (Docket 01-0628 Staff Ex. 2.0CR, p. 27). The average beta estimate for the SBWGE Electric Sample was 0.51, while the average beta estimate for the SBWGE Gas Sample was 0.58. (Docket 01-0629 Staff Ex. 2.0C, p. 27).

Ms. Kight considered two current estimates of the risk-free rate of return: the 1.89% yield on three-month U.S. Treasury bills and the 5.08% yield on thirty-year U.S. Treasury bonds, as of November 14, 2001. Forecasts of long-term inflation and the real risk-free rate suggest that the long-term risk-free rate is between 6.0% and 6.3%. Thus, Ms. Kight concluded that the thirty-year U.S. Treasury bond yield is currently the superior proxy for the long-term risk-free rate. (Docket 01-0628 Staff Ex. 2.0CR, p. 23 and Docket 01-0629 Staff Ex. 2.0C, p. 23).

To measure the expected rate of return on the market, Ms. Kight conducted a DCF analysis on the firms composing the S&P 500 Index. That analysis produced an estimate of an expected rate of return on the market equal to 15.30%. (Docket 01-0628

Staff Ex. 2.0CR, pp. 24-25 and Docket 01-0629 Staff Ex. 2.0C, p. 24). Using those parameters, Ms. Kight calculated cost of common equity estimates of 10.30% for the IPC Electric Sample and 10.96% for the IPC Gas Sample. Similary, she calculated 10.28% for the SBWGE Electric Sample and 11.04% for the SBWGE Gas Sample. (Docket 01-0628 Staff Ex. 2.0CR, p. 28 and Docket 01-0629 Staff Ex. 2.0C, p. 27).

Recommendation

Ms. Kight recommended that the cost of equity for IPC's residential electric delivery service operations be 11.14%, yielding an overall cost of capital or return on rate base of 9.52%. For SBWGE, she recommended that the cost of equity for residential electric delivery service operations be 11.02%, yielding an overall cost of capital or return on rate base of 9.26%.

3. Commission Analysis and Conclusion

The Commission finds that Staff has provided a more appropriate analysis of the cost of equity in this proceeding. Staff consistently followed accepted theoretical models and, to the extent feasible, used market-determined values. Thus, Staff's results are more forward-looking than the Companies' results that rely more heavily on historical data.

In selecting his sample, the Companies' witness, Mr. Bacalao, used the Value Line safety ranking of IPC's and SBWGE's parent company Alliant. We agree with Staff that the Value Line safety ranking can be an imprecise measure of risk. Further, his use of Alliant's safety rank is inappropriate. Alliant's safety rank reflects non-utility risks. Moreover, as a result of Mr. Bacalao's inclusion of non-utilities and foreign companies in his sample, the betas for his sample were increased, leading to higher costs of equity. The Commission rejected the inclusion of industrial companies in sample calculations in Docket 99-0117 (August 26, 1999, p. 46) and the inclusion of foreign companies in Docket 93-0301/94-0041 (consol.) (October 11, 1994, p. 66). The betas for his sample were further increased by his re-levering of the sample companies' betas to IPC's and SBWGE's financial leverage, a methodology also rejected by the Commission in previous cases. (Docket 99-0120/99-0134 (consol.), Order, August 25, 1999, p. 54; and Docket 99-0065, Order, January 9, 1995, pp. 92-93).

The Companies' analysis also relies, in part, on the comparable earnings approach that we have consistently rejected in other dockets. We do so again in this case. The cost of common equity is the market required rate of return demanded by investors. The comparable earnings approach relies on return on book equity, rather than a market required rate.

Staff's analysis is consistent with previous Commission decisions. Its sample consists of utility companies with risk similar to that of IPC and SBWGE. Staff developed estimates based on numbers derived from the Gas Sample and Electric Sample described above. We find that Staff's reliance on the Gas Sample, rather than the Electric Sample in formulating its recommendation, is appropriate because of the relative risk of the sample companies and because there are few, if any, market-traded electric delivery services companies.

We reject the Companies' argument that Ms Kight's analysis fails to take into account that the Companies must compete with non-utilities for capital and that these non-utility companies may generate a greater return on capital. The proper comparison for estimates of this type is to compare the Companies to other similarly situated utilities, not to the market as a whole. We also reject their argument that her analysis is inconsistent with that which she provided in Docket 01-0625, filed on the same day. The Companies incorrectly assert that the financial analysis of IPC and SBWGE should be "nearly identical in scope" with that performed in connection with the delivery service tariff for the small, independent Mt. Carmel Public Utility Co.

Therefore, we adopt a cost of equity of 11.14% for IPC and 11.02% for SBWGE. We also adopt Staff's overall cost of capital recommendations, incorporating its recommended capital structure, embedded cost of long-term debt, embedded cost of preferred stock and cost of common equity, which produce retuns on rate base of 9.52% for IPC and 9.26% for SBWGE, as per the following table:

Overall Cost of Capital for IPC

Capital Component	Ratio	Cost	Weighted Cost
Long-Term Debt	39.02%	7.96%	3.10%
Preferred Stock	8.43%	6.81%	0.57%
Common Equity	52.55%	11.14%	5.85%
Total	100.00%		9.52%

Overall Cost of Capital for SBWGE

Capital Component	Ratio	Cost	Weighted Cost
Long-Term Debt	43.49%	7.57%	3.29%
Preferred Stock	4.71%	5.50%	0.26%
Common Equity	51.80%	11.02%	5.71%
Total	100.00%		9.26%

VII. Rate Design and Related Issues

A. Rate Design

After a thorough review of the filings submitted by IPC and SBWGE, Staff did not recommend any changes to the delivery service rate design recommended by the Companies. The Companies are proposing to revise all non-residential delivery services rates to reflect the current proposed revenue requirement and have proposed new residential delivery service rates. Staff found the Companies' embedded cost of service studies to be acceptable for ratemaking in this case. Each is based upon the same allocation methodology that the Commission approved in the Companies' last delivery service proceeding (Dockets 99-0125/99-0133 (consol.)) and therefore may be regarded as a reasonable foundation for ratemaking in this case. Staff found that IPC and SBWGE provide a reasonable basis for determining unbundled meter services rates in this docket. IPC's and SBWGE's Rider ISS tariff for Interim Supply Service already is priced at the applicable bundled rate for residential delivery service customers. Based on the record, the Commission approves the Companies' proposed Rider ISS.

B. Terms and Conditions

Staff witness Schlaf reviewed the terms and conditions portions of the Companies' delivery services tariffs. Dr. Schlaf also reviewed the Companies' Implementation Plans.

Dr. Schlaf stated that the Companies had satisfactorily complied with the directive in the Commission's "Uniformity" Order (Docket 00-0494) that electric utilities format their delivery services tariffs in a manner consistent with the outline specified in that Attachment to the Commission's order in that proceeding. (Staff Ex. 4.0, p. 5).

Dr. Schlaf recommended that the Commission not adopt a proposed change to Section G(7) of the Companies' Supplier tariffs. (Id. pp. 5-6). Mr. Penington agreed that the Companies would eliminate that proposed change. (IPC Ex. 2.3, p. 3).

VIII. Electronic Signatures

Dr. Schlaf recommended that suppliers signing customers to electric supply contracts should be permitted to use electronic signatures to satisfy the Letter of Agency requirements discussed in Section 16-115A(b) of the Act. Under this proposal, customers could be given the option of enrolling with their chosen suppliers *via* the Internet, a practice that would be consistent with how customers purchase products and services in many industries, including the natural gas industry. (Staff Ex. 4.0, pp. 7-8).

The proposal would provide customers an additional enrollment option that many customers might find valuable. Moreover, as Dr. Schlaf noted, depriving electric suppliers the opportunity to sign up customers over their Internet web sites almost certainly has raised suppliers' marketing costs. Minimizing such costs will be especially important for suppliers considering entering the residential electric market, where per-customer profit margins may be expected to be very small. Indeed, as Dr. Schlaf noted, it very well could be the case that some marketers' entrance into the residential market may entirely depend on the availability of Internet enrollments. (Id. p. 8).

Mr. Penington stated that the Companies do not oppose Dr. Schlaf's electronic signatures recommendations, provided that the proposal does not require the Companies to operate or obtain systems that are capable of accepting electronic signatures. (IPC Ex. 2.3, p. 3). Staff notes that Dr. Schlaf's electronic signatures proposal concerns the relationship between suppliers and customers rather then the interaction between utilities and suppliers. Thus, Staff agrees that the electronic signature proposal would not require the Companies to obtain or operate systems requiring electronic signatures.

The Commission, therefore, adopts Staff's electronic signature proposal. The Companies' tariffs should be amended to make clear that customers could sign up with suppliers offering Internet enrollment. The Companies' Implementation Plan should also be amended for this purpose.

VIII. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record and being fully advised in the premises, is of the opinion and finds that:

(1) Interstate Power Company is a Delaware Corporation engaged in the generation, distribution and sale of electricity to customers at retail in this State, and as such is public utility within the meaning of the Public Utilities Act;

(2) South Beloit Water Gas & Electric Company is an Illinois corporation engaged in the distribution and sale of electricity to customers at retail in this State, and as such is a public utility within the meaning of the Public Utilities Act;

(3) the Commission has jurisdiction over Interstate Power Company and South Beloit Water Gas & Electric Company and the subject matter herein;

(4) the recitals of facts and conclusions reached in the prefatory portion of this Order are supported by the evidence of record and are hereby adopted as findings of fact, the attached Appendices A and B provide supporting calculations for various portions of this Order;

(5) the test year for the determination of the delivery services rates approved herein is the historic year ending December 31, 2000, such test year is appropriate for purposes of these proceedings;

(6) for purposes of this proceedings, Interstate Power Company's delivery services rate base is $13,982,000; South Beloit Water Gas & Electric Company's delivery services rate base is $7,603,000;

(7) for purposes of this proceedings, Interstate Power Company's delivery services revenue requirement is $5,058,000; South Beloit Water Gas & Electric Company's delivery services revenue requirement is $2,725,000;

(8) a just and reasonable rate of return which Interstate Power Company should be allowed to earn on its rate base is 9.52%, this rate of return incorporates a return on common equity of 11.14%; a just and reasonable rate of return which South Beloit Water Gas & Electric Company should be allowed to earn on its rate base is 9.26%, this rate of return incorporates a return on common equity of 11.02%;

(9) Interstate Power Company's and South Beloit Water Gas & Electric Company's Tariff Schedules, Ill. C. C. No. 13 and Ill. C. C. No. 7, respectively, and the proposed revisions to their Standard Terms, and Conditions and its Rules, Regulations and Conditions Applying to Electric Service, as modified by agreement during the course of these proceedings or as further directed in the prefatory portion of this Order, are hereby deemed to be just and reasonable; Interstate Power Company and South Beloit Water Gas & Electric Company are authorized to place these tariff sheets into effect and the tariff sheets shall be applicable to service furnished on and after their effective date of May 1, 2002;

(10) the interclass revenue allocations and rate designs discussed and accepted in the prefatory portion of this Order are just and reasonable for purposes of this proceeding and should be adopted; the delivery services tariffs filed by Interstate Power Company and South Beloit Water Gas & Electric Company should be consistent therewith;

(11) the rates contained in the tariffs filed pursuant to this Order shall be adjusted to recover the revenue requirements approved in this Order pursuant to the methodology described in the prefatory portion of this Order;

(12) Interstate Power Company and South Beloit Water Gas & Electric Company should file the new tariff sheets authorized to be filed by this Order within 10 days of the date of this Order in order to allow time for Staff review and for submission of corrected pages, if necessary, before the effective date of May 1, 2002 for those tariff sheets;

(13) Interstate Power Company and South Beloit Water Gas & Electric Company should modify their Residential Delivery Services Implementation Plan to be consistent with this Order within 10 business days following the date hereof, and shall file a copy of the modified Plans with the Commission and serve a copy of the modified Plans on all parties to this proceeding; Interstate Power Company and South Beloit Water Gas & Electric Company should also file any subsequent modifications to the Plans with the Chief Clerk of the Commission within 10 business days of the date of such modifications and provide such modifications in advance of their implementation to RESs then currently registered in their service territories;

(14) all objections, petitions or motions in this proceeding which remain undisposed of should be disposed of in a manner consistent with the ultimate conclusions contained in this Order.

IT IS THEREFORE ORDERED that Interstate Power Company and South Beloit Water, Gas & Electric Company are hereby authorized and directed to file new tariff sheets reflecting Ill. C. C. No. 13 and Ill. C. C. No. 7, respectively, and the Standard Terms, and Conditions and the Rules, Regulations and Conditions Applying to Electric Service described herein, in accordance with the Commission's findings and conclusions herein.

IT IS FURTHER ORDERED that Interstate Power Company and South Beloit Water, Gas & Electric Company shall fully comply with Findings (10), (11), (12) and (13) of this Order.

IT IS FURTHER ORDERED that any objections, petitions or motions in this proceeding which remain undisposed of are hereby disposed of in a manner consistent with the ultimate conclusions herein contained.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code Section 200.880, this Order is final; it is not subject to the Administrative Review Law.

DATED:	February 5, 2002
BRIEFS ON EXCEPTIONS:	February 20, 2002
REPLY BRIEFS:	February 26, 2002

Terrance Hilliard
Leslie Haynes
Administrative Law Judges